

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF NEW YORK

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IN RE:

THE BENNETT FUNDING GROUP, INC.  
BENNETT RECEIVABLES CORPORATION  
BENNETT RECEIVABLES CORPORATION II  
BENNETT MANAGEMENT AND DEVELOPMENT  
CORPORATION

Debtors

CASE NO. 96-61376  
96-61377  
96-61378  
96-61379

Chapter 11  
Jointly Administered

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APPEARANCES:

SIMPSON, THACHER & BARTLETT  
Attorneys for § 1104 Trustee  
425 Lexington Avenue  
New York, New York 10017

M.O. SIGAL, JR., ESQ.  
Of Counsel

WASSERMAN, JURISTA & STOLZ  
Attorneys for Unsecured Creditors Committee  
225 Millburn Avenue  
Millburn, New Jersey

DANIEL STOLZ, ESQ.  
Of Counsel  
HARRY GUTFLEISH, ESQ.  
Of Counsel

GUY VAN BAALEN, ESQ.  
Assistant U.S. Trustee  
10 Broad Street  
Utica, New York 13501

ATTORNEYS ON ADDENDUM

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,  
CONCLUSIONS OF LAW AND ORDER

Presently before this Court are a number of motions filed on behalf of various banks ("Banks") seeking relief from the automatic stay pursuant to §362(d) of the Bankruptcy Code (11 U.S.C. §101-1330) ("Code"), or in the alternative, adequate protection of their interests in certain equipment leases and the income streams derived therefrom pursuant to Code §363(e). On

December 9, 1996, Richard C. Breeden ("Trustee") filed his particularized responses in opposition to the Banks' motions, in which *inter alia* he asserted that Code §502(d) precludes the relief sought by the Banks. At the status conference held on December 12, 1996, in connection with the Banks' motions, the Court agreed to consider the discrete defense raised by the Trustee as a submitted matter for decision.<sup>1</sup>

### JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of these contested matters pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(A), (E), (G), (K), (M) and (O).

### FACTS

Voluntary petitions were filed by four related corporate entities, namely Bennett Funding Group, Inc. ("BFG"), Bennett Receivables Corporation, Bennett Receivables Corporation II, and Bennett Management and Development Corporation (hereinafter jointly referred to as "Debtors"), on March 29, 1996.<sup>2</sup> On April 18, 1996, the Trustee was appointed by the Office of the U.S.

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<sup>1</sup>Although the issue had been raised at prior status conferences and memoranda of law had been filed by various banks, as well as the Trustee, the Court, in a letter dated November 8, 1996, indicated to the Trustee that until the issue was raised in a pleading filed in a contested matter or an adversary proceeding, the Court was without authority to render a decision on the application of Code §502(d) to the Banks' lift stay motions.

<sup>2</sup>The Court approved the joint administration of the Debtors on May 3, 1996.

Trustee pursuant to Code § 1104 in the cases of the Debtors and said appointment was approved by this Court the same day.

Prior to filing, BFG was in the business of originating, purchasing and selling commercial leases of copy machines and other office equipment. For purposes of obtaining loans to finance its operations, various leases in which BFG was a lessor were compiled into portfolios designed to provide for the payment of the loan principal and interest to the Banks according to an amortization schedule. BFG in most cases collected the lease payments from the individual lessees and remitted the monies to the Banks on a monthly basis pursuant to the terms of a Servicing Agreement. Upon the filing of Debtors' petitions, BFG's payments to the Banks ceased and pursuant to various orders of the Court the Trustee has been segregating the payments received from the lessees postpetition and providing the Banks with an accounting of same. The Banks have requested that the automatic stay be modified to permit the direct collection of the lease payments by the Banks. In addition, the Banks assert an interest in the monies collected and segregated by the Trustee postpetition.

On September 18, 1996, the Trustee commenced an adversary proceeding against sixty banks, including those on whose behalf the motions herein have been filed. Pursuant to §§ 541, 542, 544, 547, 548 and 550 of the Code, Trustee's Complaint alleges sixteen causes of action against all sixty banks, and a seventeenth cause of action has also been asserted against fifteen of the sixty banks. In his Complaint the Trustee seeks a determination of the nature and extent of the defendants'/banks' interests in various property and recovery of certain property on behalf

of the Debtors' estates.<sup>3</sup>

In the contested matter now before this Court, Trustee takes the position that the Banks' pending motions for relief from the automatic stay should be denied "unless and until the Banks return all preferential transfers and fraudulent conveyances they received" as alleged in Trustee's Complaint (*see* pg. 5 of Trustee's Memorandum of Law, filed October 16, 1996). Pursuant to Code § 502(d), Trustee makes the further argument that he is "not required to obtain a judgment that a bank received a preferential transfer or fraudulent conveyance" in order to now bar a bank from pursuing its claim. Trustee requests that the Court either deny the Banks' motions or delay any proceedings on the Banks' motions until they return all preferential transfers and fraudulent conveyances to the Trustee.

### DISCUSSION

Although the Trustee commenced an adversary proceeding against some sixty Banks seeking *inter alia* to recover alleged preferential and/or fraudulent transfers, there has yet been no trial or other adjudication of the Trustee's causes of action. It is true that courts have permitted a trustee to use Code § 502(d) defensively to disallow a claim of a creditor even though the trustee lacked a judgment imposing liability for a preferential transfer. *See In re Chase &*

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<sup>3</sup>In a recent decision of the Court, dated January 2, 1997 ("January 2 Decision"), the Court dropped all defendants from the adversary proceeding, except the Bank of Herrin, but allowed the Trustee to commence individual adversary proceedings against the dropped defendants.

*Sanborn Corp.*, 124 B.R. 368, 370 (Bankr. S.D.Fla. 1991)<sup>4</sup>; *see also In re McLean Industries, Inc.*, 196 B.R. 670, 676 (S.D.N.Y. 1996); *but see In re Marketing Associates of America, Inc.*, 122 B.R. 367, 369 (Bankr. E.D.Mo. 1991) (stating that trustee may not use § 502(d) defensively to avoid a claim after expiration of statute of limitations set forth in Code § 546(a)). None of these cases were decided in the context of a motion to lift the automatic stay, however. Furthermore, their holdings make it clear that there must be some sort of judicial determination that the creditor received a preference (and has failed to repay it) before invocation of Code §502(d) is proper. *See Chase & Sanborn*, 124 B.R. at 370 (citations omitted); *see also In re Atlantic Computer Systems*, 173 B.R. 858, 862 (S.D.N.Y. 1994) (indicating that some sort of determination of claimant's liability, as well as an opportunity to turnover the property, must be made before its claims are to be disallowed).

Trustee, as well as counsel for the Official Committee of Unsecured Creditors ("Committee"), assert that the Court must interpret Code § 502(d) as written. It is their view that in order to be entitled to seek relief from the automatic stay, the Banks' claims must be "allowed" claims. Trustee argues that the plain language of Code § 502(d) "requires mandatory disallowance of the Banks' claims unless and until the amounts of the transfers have been restored to the Debtors' estates" (*see* p. 3 of Trustee's Memorandum of Law).

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<sup>4</sup>Two of the decisions cited by the court in *Chase & Sanborn* (*In re Larsen*, 80 B.R. 784 (Bankr. E.D.Va. 1987) and *Matter of Mid Atlantic Fund, Inc.*, 60 B.R. 604 (Bankr. S.D.N.Y. 1986)) were rendered in the situation in which the trustee could not obtain a judgment because he was time-barred pursuant to Code §546(a). Although the trustee was precluded from seeking affirmative relief by means of an avoidance action, nonetheless the courts permitted disallowance of the creditor's claim for purposes of distribution by the trustee.

Code § 502(d) states that

the court shall disallow any claim of any entity from which property is recoverable under section . . . 550 . . . of this title or that is a transferee of a transfer avoidable under section . . . 544, 545, 547, 548, 549 . . . unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under . . . 550 . . . of this title.

In *Chase & Sanborn* there had been a determination that the creditor had received two preferential payments, but there had been no determination of the amount of prejudgment interest. *See Chase & Sanborn*, 124 B.R. at 370. The court concluded that the creditor should be required to pay \$1,550,000 in preferences or have its claims disallowed. *See id.* at 371. The court also found that the creditor would be permitted to continue to litigate its claims against the estate provided the principal amount of the voidable preferences were turned over to the estate. *See id.*

In *McLean Industries* the bankruptcy court determined that the grant of a security interest prepetition to a creditor was an avoidable preference under Code § 547. *See McLean Industries*, 196 B.R. at 673. The decision was affirmed by the district court; however, the Court of Appeals for the Second Circuit held that the avoidance action brought by the debtor was time-barred and remanded the proceeding to the bankruptcy court to determine whether the claim of the creditor should be disallowed under Code § 502(d). *See id.* On remand the bankruptcy court concluded that even though the debtor was unable to avoid the lien as a preference because of the time limits of Code § 546(a), the debtor could invoke Code § 502(d) defensively to disallow the creditor's claim. *See id.* at 675. The district court affirmed the bankruptcy court's decision, finding that since there had previously had been a determination that the creditor received a preferential transfer, Code § 502(d) mandated disallowance of the creditor's claim. *See id.* at 677.

In the matter *sub judice*, the Trustee timely commenced an adversary proceeding against

the Banks seeking *inter alia* to recover alleged preferences and fraudulent conveyances. At this juncture, however, there has been no determination that any alleged transfers between BFG and the Banks are avoidable by the Trustee within the context of the adversary proceeding. The question then arises whether the hearings on the Banks' motions seeking relief from the automatic stay are the appropriate forums in which to allow the Trustee to make a *prima facie* case establishing that the Banks received preferential transfers or fraudulent conveyances for which Trustee is entitled to recover before the Banks are granted the relief they seek.

In *In re Pappas*, 55 B.R. 658 (Bankr. D.Mass. 1985), the issue before the court was "whether the Trustee may introduce evidence regarding alleged postpetition payments made by the Debtor to the Bank at a hearing on the Bank's request for relief from the automatic stay." *See id.* at 659. The court in *Pappas* pointed out that hearings on relief from the stay "are not the proper forum for deciding counterclaims by a debtor against a creditor." *Id.* at 660 (citations omitted). However, the court also left the door open to the possibility that in exercising its discretion the court should also consider factors that might bear on the resolution of whether the bank was entitled to relief from the stay. *See id.* (citations omitted). Indeed, the court discussed the fact that actions under Code §§ 547 and 548 which challenge the validity of a secured creditor's lien "should be considered at a hearing on relief from the automatic stay." The court in *Pappas* suggested that the Trustee file a complaint seeking to avoid certain transfers, "pleading with great specificity and particularity as to dates and amounts," which the court then would consider in the context of the relief sought by the bank. *See id.* at 661. The court indicated, however, that it would not conduct a full hearing on the trustee's claims at the hearing on relief from the stay. *See id.*; *see also Grella v. Salem Five Cent Sav. Bank*, 42 F.3d 26, 33 (1st Cir.

1994) (stating that "[t]o allow relief from the stay hearing to become any more extensive than a quick determination of whether a creditor has a colorable claim would turn the hearing into a full scale adversary lawsuit. . . (citation omitted)).

This approach is consistent with the legislative history of Code § 362 in which Congress indicated that

counterclaims are not to be handled in the summary fashion that the preliminary hearing under this provision will be. Rather, they will be the subject of more complete proceedings by the trustee to recover property of the estate or to object to the allowance of a claim. However, this would not preclude the party seeking continuance of the stay from presenting evidence on the existence of claims which the court may consider in exercising its discretion. What is precluded is a determination of such collateral claims on the merits at the hearing.

S.Rep. No. 989, 95th Cong. 2d Sess. 55, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5841.

"Hearings to determine whether the stay should be lifted are meant to be summary in character." *See Matter of Vitreous Steel Products Co.*, 911 F.2d 1223, 1232 (7th Cir. 1990). Code § 362(e) requires an expedited hearing on the motion. Indeed, prior to the Bankruptcy Reform Act of 1994, the Code required only that the Court **commence** a final hearing within 30 days of the preliminary hearing. The statute in its current form requires that the Court **conclude** the final hearing within 30 days "unless the 30-day period is extended with the consent of the parties in interest or for a specific time which the court finds is required by compelling circumstances."<sup>5</sup>

The legislative history of Code § 362 indicates that at the hearing "the only issue will be the lack of adequate protection, the debtor's equity in the property, and the necessity of the

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<sup>5</sup>Due to the unique circumstances of these cases, the Court on April 26, 1996, issued its Omnibus Order Extending Time for Final Hearing pursuant to 11 U.S.C. § 362(e). That Order has been extended from time to time.



property to an effective reorganization of the debtor or the existence of other cause for relief from the stay." S.Rep. No. 989, 95th Cong. 2d Sess. 55, *reprinted in* 1978 U.S.S.C.A.N. 5787, 5841, H.R. Rep. No. 595, 95th Cong. 2d Sess. 344, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6300-6301. "Defenses of nonperfection of the security interest, unconscionability, challenges to the outstanding indebtedness, usury, the statute of frauds and lack of consideration generally constitute 'direct defenses' to the lienholder's request for relief from the stay and should be determined as part of the stay litigation." *Nat'l Westminster Bank, U.S.A. v. Ross*, 130 B.R. 656, 670 n.9 (S.D.N.Y. 1991), *aff'd sub. nom. Yaeger v. Nat'l Westminster*, 962 F.2d 1 (2d Cir. 1992).

The Court finds no statutory authority, however, which requires the Court to adjudicate the Trustee's objections to the Banks' claims grounded upon Code §§ 547 and 548 in the context of the hearings on the motions for relief from the stay which are intended to be summary proceedings. The courts, however, as discussed above, have been amenable to giving **consideration** to the alleged voidability of a lien, for example, even though declining to allow **adjudication** of whether the secured party's lien is voidable. *See In re Roxrun Estates, Inc.*, 74 B.R. 997, 1003-1004 (Bankr. S.D.N.Y. 1987).

With this in mind, the Court deems it appropriate to adopt the approach suggested by the court in *Pappas*. The Court will neither deny the Banks' motions at this juncture nor delay the hearings on said motions. However, the Court will consider the Trustee's allegations of preferences and fraudulent conveyances to the extent that the Trustee has or will file complaints against the individual banks pursuant to this Court's January 2 Decision, particularizing both the

amounts and dates of the transfers he asserts are avoidable.<sup>6</sup> In order not to delay the Court's decisions, the complaints must be filed prior to the each of the hearings on the Banks' respective motions, which are scheduled to commence in mid-March 1997, if the Trustee wishes the Court to consider them. The Court will not, however, permit actual litigation of the Trustee's avoidance actions within the context of the hearings on the Banks' lift stay motions.

IT IS SO ORDERED.

Dated at Utica, New York

this 8th day of January 1997

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STEPHEN D. GERLING  
Chief U.S. Bankruptcy Judge

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<sup>6</sup>Since Trustee's complaint against the Bank of Herrin was not dismissed, it will be necessary for the Trustee to amend that complaint to include specific dates and amounts of any alleged voidable transfers he wishes the Court to consider in connection with the hearing on the Bank of Herrin's lift stay motion.

**ADDENDUM A****LIST OF BANKS SEEKING RELIEF FROM THE AUTOMATIC STAY  
OR SEEKING ADEQUATE PROTECTION FOR USE OF CASH COLLATERAL**

Alston & Bird  
Attn: John C. Weitnauer  
1201 W. Peach Tree St.  
Atlanta, GA 303309-3424

First Federal Bank of LaGrange

Bond, Schoeneck & King  
Attn: James Dati  
One Lincoln Center, #1800  
Syracuse, NY 13202

Bank of Herrin, The  
Berkshire County Savings Bank  
Carterville State and Savings Bank  
Central Bank & Trust Company  
Citizens National Bank of Albion  
Citizens State Bank of Shipman  
First Community Bank FSB  
First National Bank of Carmi  
First National Bank of Ottawa  
Grand Marais State Bank

DeGraff, Foy, Holt-Harris, Mealy & Kunz  
Attn: John D. Rodgers  
90 State Street  
Albany, NY 12207

Citizens State Bank of Arlington  
Citizens State Bank of Shipman  
First National Bank of Newton  
Hawkeye Federal Savings Bank of Boone, Iowa (700)  
Oswego City Savings Bank  
People's Trust Company  
Republic Bank  
Union Bank Company

Deily, Testa & Dautel  
Attn: Jonathan D. Deily  
80 State Street, 10th Fl.  
Albany, NY 12207

Citizens National Bank of Malone  
Greene County Savings Bank  
National Bank of Cossack, The

Drinker, Biddle & Reath  
Attn: Andrew C. Kassner  
1100 PNB Bank Building  
1345 Chestnut Street  
Philadelphia, PA 19107

First Keystone FSB  
Greater Delaware Valley FSB  
Roxborough Manayunk FSB  
Third Federal Savings Bank  
Willow Grove Bank

Felt, Evans, Panzone, Bobrow & Halak  
Attn: Edward D. Earl  
4-6 North Park Road  
Clinton, NY 13323

Tolland Bank

David L. Ganje  
Executive Park North  
Albany, NY 12203

English State Bank  
Howard Bank, N.A., The

Green & Seifter  
Attn: Robert K. Weiler  
900 Lincoln Center  
Syracuse, NY 13202

Metrobank

People's Bank and Trust Company, The  
Hancock & Estabrook  
Attn: Stephen A. Donato  
1500 MONY Tower I  
Syracuse, NY 13202

American Community Bank  
Amerifirst Bank, NA  
First National Bank of Northwest, Ohio  
American State Bank and Trust of Wiliston  
Androscoggin Savings Bank  
Bank of Tioga  
Bay Area Bank  
Bay State Savings Bank  
Community Bank  
East Side Bank and Trust Company  
First National Bank of Waconia  
First Northern Bank & Trust  
First State Bank of Wabasha  
First State Bank, The  
Firststar Bank FSB  
Framingham Cooperative Bank  
Gloucester Bank & Trust Company  
Hibernia Savings Bank, The  
Hawkeye FSB  
Hudson United Bank  
LaCrescent State Bank  
Leavenworth National Bank & Trust Co.  
Marine Midland Bank  
Medway Savings Bank  
Mercantile Bank of Southern Illinois  
Merchants National Bank of Winona  
Merchants State Bank  
Mutual FSB of Plymouth County  
Norwood Cooperative Bank  
North Adams Hoosac Savings Bank  
Oswego City Savings Bank  
Park West Bank and Trust Company  
Safety Fund National Bank  
Sprague National Bank  
Stoneham Savings Bank  
Twentieth Street Bank  
Western Bank of Wolfpoint  
Wilbur National Bank

Harter, Secrest & Emery  
Attn: Gary Karl  
700 Midtown Tower  
Rochester, NY 14604

Liberty Bank  
South Trust County Bank of Georgia

Katten Muchin & Zavis  
Attn: Mark K. Thomas  
525 West Monroe St. - Suite 1600  
Chicago, IL 60661-3693

Heller Financial Inc.  
Heller Financial Leasing, Inc.

Kilpatrick & Cody  
Attn: Todd C. Meyers  
Suite 2800  
1100 Peachtree Street  
Atlanta, GA 30309-4530

American National Bank  
Citizens State Bank of Milford  
Etowah Bank  
Farmers & Merchants Bank  
Monroe County Bank  
Weakley County Bank

Kurtzman, Cohen, Matera & Gurock  
Attn: Rosemarie E. Matera  
9 Perlman Dr.  
Spring Valley, NY 10977

Union State Bank  
The Legal Center  
Attn: Jerome Sharfman  
Suite 500, One Riverfront Plaza  
Newark, NJ 07102

Fidelity Federal Savings Bank

MacKenzie, Smith, Lewis, Mitchell & Hughes  
Attn: Anthony R. Hanley  
600 OnBank Bldg.  
101 S. Salina Street  
Syracuse, NY 13202

Bank of Bellevue  
Central State Bank, Muscatine, Iowa  
Citizens Bank, Corydon, Iowa  
Citizens Bank, Leon, Iowa  
Citizens Bank, Princeton, Missouri  
Douglas County Bank and Trust Company  
Farmers and Merchants Bank, Watertown, South Dakota  
Home Federal Savings and Loan Association

Melvin & Melvin  
Attn: Louis Levine  
217 South Salina St.  
Suite 700  
Syracuse, NY 13202

Citrus Bank  
ESB Bank

Ravin, Sarasohn, Cook,  
Baumgarten, Fisch & Rosen  
Attn: Mitchell B. Seidman  
103 Eisenhower Parkway  
Roseland, NJ 07068-1072

Interchange State Bank

Rossi, Murnane, Balzano & Hughes  
Attn: Thomas P. Hughes  
209 Elizabeth St.  
Utica, NY 13503

Tucker Federal Savings and Loan

Whitelaw & Fangio  
Attn: Mary Fangio  
247-259 W. Fayette Street  
Syracuse, NY 13202

Bank of St. Petersburg

McGrath & Associates, P.C.  
Attn: Paul S. McGrath, Esq.  
10th Floor, The Bank Tower  
307 Fourth Ave.  
Pittsburgh, PA 15222

Deposit Bank

Lindquist & Verrum, P.L.L.P.  
Att: Daryle L. Uphoff, Esq.  
4200 IDS Center  
80 S. Eighth St.  
Minneapolis, MN 55402

Citizens Bank of St. James  
Bank of Elmore  
Melrose State Bank  
Pioneer Bank  
Rocky Mountain Bank  
Round Bank